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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

THE STATE OF NEW JERSEY,

Petitioner,

v.

READING COMPANY, Debtor in Reorganization, THE UNITED STATES OF AMERICA, CONSOLIDATED RAIL CORPORATION and the COMMITTEE OF INTERLINE RAILROADS,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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Questions Presented

1. May a bankruptcy court in a proceeding for the reorganization of a railroad, having ordered the deferral of the payment of taxes accruing during the pendency of the reorganization, approve a plan of reorganization which fails to provide for full prompt cash payment of the deferred taxes.

2. Does a plan of reorganization conform to the "fair and equitable" requirement of Section 77(e)(1) of the Bankruptcy Act if it provides for payment of only 30% of deferred administration real estate taxes in cash at consummation, and no cash at consummation for deferred administration franchise tax claims, with the balance of these tax claims to be paid in the form of long term low interest notes of uncertain payment, and yet provides for extensive cash payments to lower priority secured and unsecured creditors both at consummation and during the initial years of the reorganized company as well as the retention of cash not needed for the feasibility of the reorganized company.

3. Do the limitations on Congressional power set forth in the Tenth Amendment to the Constitution of the United States bar the approval by a Section 77 reorganization court of a plan of reorgainzation which provides for the payment of deferred administration tax claims in the form of long term low interest notes of uncertain payment.

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READING COMPANY, Debtor in Reorganization, THE UNITED STATES OF AMERICA, CONSOLIDATED RAIL CORPORATION and the COMMITTEE OF INTERLINE RAILROADS,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

The petitioner, State of New Jersey, respectfully prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit in Appeal No. 80-1993, entered on September 23, 1980, affirming Order No. 1804 of the United States District Court for the Eastern District of Pennsylvania which approved a Plan of Reorganization for the Reading Company.

Opinion Below

The opinion and order of the United States District Court for the Eastern District of Pennsylvania, not yet reported, is set forth in the Appendix A hereto. The Court of Appeals for the Third Circuit did not render an opinion but decided the case by entry of a judgment order set forth in Appendix B hereto.

Jurisdiction

The judgment of the Court of Appeals was entered on September 23, 1980. A timely petition for rehearing *en banc* was denied on October 17, 1980, and this petition for *certiorari* was filed within 90 days of that date. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

Statutory and Constitutional Provisions Involved

Bankruptcy Act § 77(e)(1) (11 U.S.C. § 205(e)(1)):

> ". . . the judge shall approve the plan if satisfied that: (1) It complies with the provisions of subsection (b) of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; . . ."

Bankruptcy Act § 77(e)(3) (11 U.S.C. § 205(e)(3)):

> ". . . the judge shall approve the plan if satisfied that: . . . (3) the plan provides for the payment

> of all costs of administration and all other allowances made or to be made by the judge, except that allowances provided for in subsection (c), paragraph (12) of this section, may be paid in securities provided for in the plan if those entitled thereto will accept such payment, and the judge is hereby given power to approve the same."

28 U.S.C. § 960:

> "Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and Local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation."

Tenth Amendment of the Constitution of the United States:

> "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively or to the people."

Statement of the Case

On November 23, 1971, the Reading Company filed a petition for reorganization of a railroad under Section 77 of the Bankruptcy Act (11 U.S.C. § 205). The court appointed Trustees thereafter sought and won authorization by the court to defer the payment of taxes accruing during the pendency of the reorganization proceedings. The reorganization court's order, Order No. 186, entered on July 18, 1972, also enjoined the taxing authorities from taking any action to collect the unpaid taxes (Pa7 to

Pa9).* The trustees accordingly did not pay taxes on a current basis from July of 1972 until the end of 1978 when the reorganization court approved the resumption of tax payments. Consequently, the State of New Jersey has tax claims against the Trustees for the years 1972 through 1977 in the amount of a quarter of a million dollars.**

The Trustees filed a Proposed Plan of Reorganization on June 25, 1979 (Pa10 to Pa39). The Plan proposed the establishment of eight separate classes of claims. State and local real estate tax claims were to be placed in Class C. State and Local corporate tax claims were included in Class D along with a variety of other claims which arose during the reorganization (Pa20). The State of New Jersey has both Class C real estate and Class D corporate franchise tax claims.

The plan proposed to satisfy the State's real estate tax claims by payment of 30% of the claim in cash and 70% of the claim in Series B Administrative Notes (Pa26). The plan specified that the Series B Notes were to be contingent obligations of the reorganized company which would bear interest at 8% per annum, compounded annually, from and after the date of consummation of the plan. The notes are to be secured by a second lien on a designated portion of the proceeds of the Valuation Case, the proceedings before the Special Court to determine the com-

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* This notation refers to the appendix filed by the State with the Court of Appeals for the Third Circuit.

** It should be noted that if the taxes which had become due on properties owned by certain *non-bankrupt* entities connected with the Debtor's operations had not been paid at the time said properties were sold, the amount would have approached a million dollars.

pensation that the Reading Company is to receive for conveyance of its rail assets to the Consolidated Rail Corporation pursuant to the Regional Rail Reorganization Act 45 U.S.C. §701 *et seq.** The notes are secured by "additional compensation," which the plan defines as those valuation case proceeds received by the debtor in excess of the net liquidation value of the transferred assets as fixed by the United States Railway Association with the interest due thereon (Pa16). The Series B Notes fall due 90 days after liquidation of all or a portion of the Valuation Case proceeds to cash. Accrued interest is only to be paid when the Notes are redeemed. If there is, in fact, no additional compensation, the Series B Notes are null and void. The plan estimates that the earliest date for resolution of the Valuation Case will be April 1, 1988 (Pa22).

The State and local franchise tax claims in Class D are to be satisfied, if not settled, by issuance of Series C Administration Notes in an amount equal to the claim. The Series C Notes are to be general obligations of the reorganized company, with interest accruing at 8% per annum, compounded annually. These notes, too, are tied to the Valuation Case in terms of time and source of payment. The notes mature on April 1, 1988 or 90 days after liquidation of all or a portion of Valuation Case proceeds to cash, whichever is the first to occur. The Series C Notes are secured by a lien on valuation case proceeds although this lien is junior to the first priority lien securing the Series A Notes as to all valuation case proceeds, and

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* A first priority lien upon all valuation case proceeds is to be established in favor of the Series A Administration Notes to be issued to the United States in satisfaction of its claims for loans advanced under Section 211(h) of the Rail Act, 45 U.S.C. §721(h) and claims under Trustees' Certificates. These claims total some $31.6 million (Pa150)

junior to the lien securing the Series B Notes as to "additional compensation" (Pa22).

While providing for the further deferral in payment of 70% of the real estate tax claims, and 100% of the corporate tax claims, the plan proposed extensive cash payments to lower priority secured and unsecured creditors. Class F included two types of secured claims: Principal and interest on Government Guaranteed Loans and principal and interest on the 1954 Mortgage Bonds. The plan proposed to aggregate the interest on both. Interest on the government loan was to be paid with 25% in cash and 75% in Series A Bonds. The percentage treatment was the same for the interest on the 1945 Mortgage Bonds, however, Series B Bonds rather than Series A Bonds would be issued (Pa27). Both series of bonds bear interest at 10% per year. The plan provided for the mandatory redemption of the Series A Bonds each year with full payment by the fifth anniversary of the date of consumption, and mandatory redemption of the Series B Bonds by the sixth anniversary (Pa23). Exhibits to the plan, as revised through June 30, 1980, indicated that over $21.6 million in Series A and Series B Bonds are to be issued (Pa150).

The principal due on the 1945 Mortgage Bonds was proposed to be satisfied by issuance of Series C-1 Bonds. Series C-2 Bonds are to be issued to satisfy the unpaid principal of the Government Guranteed Loans. The proposed plan called for mandatory redemption of the Series C Bonds commencing one year from the date after the Series A and Series B Bonds and interest thereon have been paid in full. The plan specified that some $3 million in principal face amount of the Series C Bonds were to be redeemed each year after the Series A and B Bonds were paid until the C Bonds matured on April 1, 1988 or

90 days after liquidation of all or a portion of the valuation case proceeds to cash, whichever is the first to occur (Pa23 to Pa24).

The unsecured personal injury claims, in Class G, were proposed to be satisfied by cash payment of one-third (33⅓%) of the claims on consummation date. The remaining two-thirds was to be satisfied by issuance of Personal Injury Notes which provide for payment of one-third of the original claim on the first anniversary. The entire class of unsecured personal injury claims is to be paid by the second anniversary of consummation (Pa28). Over $2 million in Personal Injury Notes are to be issued (Pa150).

The State objected to the plan because it failed to provide full prompt cash payment of the deferred taxes and contemplated yet a further deferral of the Trustees' duty to pay taxes as they accrue during reorganization; because it failed to provide prompt cash payment of the State's long deferred administration tax claims in violation of Section 77(e)(3) of the Bankruptcy Act; because the plan provided for a distribution of cash to lower priority creditors and the retention of cash not necessary to the feasibility of the company in violation of Section 77(e)(1); and because the plan's proposed treatment of tax claims was violative of the Tenth Amendment of the Constitution of the United States.

On May 21, 1980, after approving amendments to the plan, the reorganization court entered Order No. 1804 approving the plan over the State's objections (App.A). The reasons for the approval were set forth in an accompanying opinion (App.A). The reorganization court determined that the State of New Jersey was not entitled to cash payment of its tax claims, that the plan was fair and equitable, and that the plan was feasible. On appeal to the United States Court of Appeals for the Third Circuit,

the judgment of the reorganization court was affirmed without opinion by entry of a judgment order on September 23, 1980 (App.B). On October 17, 1980, the Court of Appeals denied the State's petition for rehearing *en banc* (App.C).

REASONS FOR GRANTING THE WRIT

POINT I

The Court should grant the Petition for a Writ of Certiorari so that it may determine whether a Section 77 Reorganization Court is empowered to approve a plan of reorganization which fails to provide full prompt cash payment of taxes which became due and owing during reorganization but which were not paid due to the entry of a tax payment deferral order.

The decisions of this Court establish that a Trustee, while conducting the business of a debtor railroad, is subject to state and local taxes and must pay them as they accrue. In *In re Tyler,* 149 U.S. 164 (1893), a railroad receivership action, the Court stated that removal of a taxing authority's power to seize and sell a railroad's property to obtain payment of its taxes made

> "imperative [the] duty of the court to recognize as paramount, and enforce with promptness and vigor, the just claims of the authorities for the prescribed contributions to state and municipal revenue." *Id.* 149 U.S. at 187.

So, too, in *Michigan* v. *Michigan Trust Co.,* 286 U.S. 334 (1932), Justice Cardozo, writing for the Court, stated with respect to taxes accruing during receivership:

> "[T]he receiver was under a duty to pay them when they accrued, and having failed to fulfill that duty then, it should be compelled to pay them now." *Id.* 286 U.S. at 345.

In 1934, Congress enacted 28 U.S.C. §124a, a predecessor to the present 28 U.S.C. §960, which states:

> "Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation."

The plain terms of the statute require a trustee in bankruptcy to pay State and Local taxes in the same manner and to the same extent as if the debtor's business were conducted by an individual or corporation. *Nicholas* v. *United States,* 384 U.S. 678, 690 (1966); *Palmer* v. *Webster & Atlas Bank,* 312 U.S. 156, 163 (1941); *Philadelphia Co.* v. *Dipple,* 312 U.S. 168, 175 (1941); *Lyford* v. *State of New York,* 140 F.2d 840, 846 (2d Cir. 1944).

It is clear that 28 U.S.C. §960 requires that a Trustee pay State and Local taxes as they accrue. The reorganization court so stated. *In re Reading Co.,* 439 F.Supp. 389, 391 (E.D. Pa. 1977). Nevertheless, the Court had approved the deferral of the payment of taxes by entry of Order No. 186. The legal basis for the entry of that order was the decision of the Court of Appeals for the Third Circuit in *In the Matter of Penn Central Transportation Co.,* 452 F.2d 1107 (3rd Cir. 1971), *cert.* den. *New Jersey* v. *Penn Central Transportation Co.,* 406 U.S. 944 (1972), wherein the Third Circuit concluded that a Section 77 reorganization court was empowered to *temporarily* defer the payment of taxes accruing during reorganization. While recognizing that this Court's decision in *Michigan* v. *Michigan*

Trust Co., supra, obligated the Trustees to pay taxes "as they accrue," the Court of Appeals nonetheless concluded that the Trustees' obligation to perform that duty could be *temporarily* postponed in light of the need to preserve the railroad as an operating unit in the public interest. *In the Matter of Penn Central Transportation Co., supra,* 452 F.2d at 1108, n.1.

The deferral of the current payment of taxes sanctioned by the Third Circuit in *Penn Central* has become the rule in railroad reorganizations. Order No. 186 in this matter was entered shortly after the decision of the Court of Appeals. Similar tax payment deferral orders have been entered in *In the Matter of Erie Lackawanna Railway Co.,* (B72-2838 N.D. Ohio); *In the Matter of Lehigh Valley Railroad Co.,* (Bky No. 70-432 E.D. Pa); and in *In the Matter of New York, Susquehanna and Western Railroad Co.,* (Bky No. 76-182 D. N.J.). The State of New Jersey has tax claims in each of these pending matters which represent the deferral of over $20 million in taxes and accrued interest.

By affirming the reorganization court's approval of a plan of reorganization which does not provide for the full, prompt cash payment of the State's tax claims, the Court of Appeals has approved yet a further deferral of the Trustees' duty to pay the already too long deferred taxes. Taxes which became due as early as 1972 may not be paid, if they are paid at all, until 1988. This is so despite the fact that the initial rationale for deferral, the need to preserve the railroad as an operating unit, no longer exists. The Reading Company no longer operates a railroad in the public interest, having transferred its rail assets to the Consolidated Rail Corp. on April 1, 1976 pursuant to the Regional Rail Reorganization Act, 45 U.S.C. §701 *et seq.* See *Regional Rail*

Reorganization Act Cases, 419 U.S. 102 (1974). Further deferral of the payment of the State's tax claims is contrary to the original understanding upon which the taxes were deferred, is contrary to the plain terms of 28 U.S.C. §960, and compounds the egregious intrusion upon State sovereignty represented by the initial and supposedly "temporary" deferral order. See *National League of Cities* v. *Usery,* 426 U.S. 833 (1976).

Although other costs and expenses of administering the debtor's estate were paid on a current basis, the payment of taxes was deferred on the understanding that deferral would be temporary and would not result in unequal treatment among administration claimants. The Court of Appeals in *In the Matter of Penn Central Transportation Co., supra,* held that all administration expenses must be treated equally but ruled that simultaneous payment was not required. *Id.,* 452 F.2d at 1108. Under the approved plan, there would be not only an extreme difference in the timing of payment but also a difference in the mode of payment since the deferred taxes are to be paid principally in the form of long term notes not cash. Since the notes are secured by the uncertain proceeds of the Reading Valuation Case, it is quite possible that the deferred taxes might never be paid.

In addition to the Congressional mandate of 28 U.S.C. § 960, Section 77(e)(3) of the Bankruptcy Act requires that a reorganization court approve a plan of reorganization only if satisfied that, *inter alia*:

> ". . . the plan provides for the payment of all costs of administration and all other allowances made or to be made by the judge, except that allowances provided for in subsection (c), paragraph

> (12) of this section, may be paid in securities provided for in the plan if those entitled thereto will accept such payment . . ."*

The plain terms of Section 77(e)(3) require that administration expenses be paid in cash. Securities may only be used to satisfy expenses that fall within the purview of Section 77(c)(12) and then only when those claimants agree to accept payment in securities. *In re New York, New Haven and Hartford R. Co.,* 304 F.Supp. 1121, 1126 (D.Conn. 1969); *In the Matter of Central Railroad Co. of New Jersey,* 425 F.Supp. 1055, 1060 (D.N.J. 1977), vac. and rem. o.g. 579 F.2d 804 (3rd Cir. 1978).

In this matter the reorganization court, in reliance upon *In the Matter of Penn Central Transportation Co.,* 458 F.Supp. 1234 1282 (E.D. Pa. 1978), concluded that Section 77(e)(3) requires payment of only "expenses directly associated with the reorganization proceedings, such as compensation for trustees and attorneys." (App. A, p. 28). The decided cases thus represent a substantial difference of opinion among the reorganization courts that have construed Section 77(e)(3). In affirming the Reading reorganization court's crabbed interpretation of Section 77(e)(3), the Third Circuit has adopted a far reaching interpretation of the statute. This interpretation is contrary to the well established principle that State and local tax claims accruing during reorganization are expenses of administration. *In the Matter of Penn Central Transportation Co., supra.,* 452 F.2d at 1108; *Southern Ry.* v. *United States,* 306 F.2d 119, 126 (5th Cir. 1962); *In re New York, New Haven and Hartford R. Co.,* 147 F.2d 40, 52-53

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* Section 77(c)(12) allows the reorganization court to make allowance for expenses incurred in the proceedings, including attorney's fees, which are to be paid out of the debtor's estate.

(2d Cir. 1945), *cert.* den. 325 U.S. 884 (1945). Exclusion of these costs from the scope of Section 77(e)(3) is contrary to the terms of the statute and in conflict with the underlying purpose of a reorganization. As one reorganization court has said:

> "Besides having a strong foundation in the wording of the statute, the traditional rule that reorganization expenses must be paid in cash make sense. The reorganization process depends in large part upon the ability to continue operations pending reorganization. The continued reorganization depends, in turn, upon the willingness of other business and governmental entities, as well as employees, to continue to deal with the trustee of the bankrupt estate. If they cannot be persuaded to extend credit for such necessities as fuel, supplies, and labor, the reorganization process would be severely handicapped, if not entirely frustrated. Thus, it would seem logical to ensure the potential administration creditors that they will be paid in cash, not in securities of the reorganized company, securities of other companies, or in kind, *i.e.* a box car." (footnotes omitted) . *In the Matter of Central Railroad Company of New Jersey, supra,* 425 F. Supp. at 1062.

In short, the decision of the Court of Appeals, in allowing the further deferral of the State's long deferred tax claims, is in conflict with the Congressional mandate of 28 U.S.C. §960, the decisions of this Court, and the requirements of Section 77(e)(3). The question is one of the utmost importance in the administration of the Bankruptcy Laws. Its importance requires review by this Court. The Petition for a Writ of Certiorari should be granted.

POINT II

A Writ of Certiorari should issue to the Court of Appeals for the Third Circuit so that this Court may review the Third Circuit's determination that the plan of reorganization approved by the Reading reorganization court is consistent with Section 77(e)(1) of the Bankruptcy Act and the prior decisions of this Court.

Even if the Third Circuit were correct in holding that full, prompt cash payment of the State's claims is not required by 28 U.S.C. §960 or Section 77(e)(3), the approval of the Reading plan would nonetheless be contrary to the requirements of Section 77(e)(1) of the Bankruptcy Act, 11 U.S.C. §205(e)(1). Section 77(e)(1) requires that before approving a plan of reorganization, the reorganization court must be satisfied that the plan is

> ". . . fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders. . . ."

The "fair and equitable" requirement, also known as the "absolute priority rule," mandates that senior claimants receive the full value of their claims out of the debtor's estate before junior claimants receive anything for their interests. *Case* v. *Los Angeles Lumber Products Co.*, 308 U.S. 106, 116 (1939); *Northern Pacific Ry. Co.* v. *Boyd*, 228 U.S. 482, 505 (1913). No plan can be deemed "fair and equitable" if it compromises the rights of senior creditors in order to protect those with lower priorities. See *United States* v. *Key*, 397 U. S. 323, 327 (1970).

It is well settled that the "absolute priority rule," confers upon a senior claimant the primary right to be pre-

ferred to lower priority creditors against the full value of all of the property belonging to the debtor corporation. *Kansas City Terminal Ry.* v. *Central Union Trust Co.*, 271 U.S. 445, 454 (1926). The rule requires that each senior claimant be given such opportunity as the circumstances permit to secure the full enjoyment of this preference. A senior claimant is therefore entitled to full compensatory treatment with the best consideration available under the existing circumstances. Anything less runs afoul of the rule and comes within judicial denunciation. *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co., supra; Consoliated Rock Products Co.* v. *DuBois,* 321 U.S. 510, 529 (1941).

The Third Circuit's judgment in this matter represents a fundamental departure from the strictures of the "absolute priority rule" and the decisions of this Court which declare the rule to be a "fixed principle" which must be rigidly adhered to. *Kansas City Terminal Ry.* v. *Central Union Trust Co., supra,* 271 U.S. at 454. See also *Northern Pacific Ry. Co.* v. *Boyd, supra,* 228 U.S. at 507. The plan's violation of the "fair and equitable" requirement is clear. Under the plan, the State's high priority real estate tax claims are to receive only 30% in cash at consummation. The balance is to be paid by issuance of notes which are contingent obligations of the reorganized company which are to be paid only if there are sufficient proceeds from the Reading Valuation Case (Pa22). The State's high priority franchise tax claims are to receive no cash at consummation and will be entirely paid with notes also secured by the uncertain proceeds of the Valuation Case litigation (Pa22). The notes issued in respect of the real estate and the franchise tax claims are not to be paid until the conclusion of the Valuation Case which is estimated to occur no earlier than April 1, 1988.

While 70% of the State's real estate tax claims and 100% of the State's franchise tax claims are deferred to April 1, 1988, the plan of reorganization nevertheless provides for extensive cash payments to secured and unsecured creditors both at consummation and during the early years of the reorganized company. At consummation, $7.220 million is to be distributed to secured creditors (Pa150). Bonds will be issued to the secured creditors which will guarantee payment of $6.132 million in 1981, $5.735 million in 1982, $5.338 million in 1983 and $4.941 million in 1984 (Pa148). Although not reflected upon the Trustees' financial exhibits additional cash payments to secured creditors will total $4.54 million in 1985, $2.01 million in 1986, and $4.68 million in 1987.

At consummation, $1.191 million is to be paid to unsecured personal injury claimants representing 33⅓% of the claims (Pa150). An additional 33⅓% is to be paid on the first anniversary of the consummation, and the remaining balance on the second anniversary. In addition the reorganized company is to retain $13.7 million at consummation (Pa148).

It is fundamental that a plan of reorganization which contemplates full payment of unsecured claims before full payment is made to higher priority administration claims runs afoul of the "absolute priority rule." Similarly, the extensive guaranteed cash payments to secured creditors while the higher priority tax claims are deferred is violative of the rule. Clearly, the financial circumstances of the reorganized company compel the prior application of the available cash to the State's tax claims which have unquestioned priority over the secured and unsecured creditors who are being preferred by earlier, partial payment.

Even were it to be concluded that Section 77(e)(1) does not mandate the full cash payment of senior claims before any payment is made to junior creditors, the combinations of cash and securities to be parcelled out to the claimants and creditors fails to recognize the relative priorities of the claimants and creditors. The unsecured personal injury creditors are to receive a greater percentage of their claims in cash at consummation than the State is to receive for its tax claims. These unsecured creditors are to receive notes which guarantee payment within two years of consummation, while the State is to receive notes which are estimated to be paid, if at all, no earlier than April 1, 1988. The secured creditors are to receive notes which bear interest at 10% while a mere 8% is to accrue on the notes issued to tax claimants (Pa23 to Pa24).

In addition, the "fair and equitable" requirement of Section 77(e)(1) mandates full compensatory treatment for senior claims before junior claims are paid. Without full compensation, property rights of a senior claimant are appropriated by and for the benefit of lower priority creditors. See *Consolidated Rock Products Co.* v. *DuBois, supra,* 312 U.S. at 529. The tax liabilities at issue are established by virtue of the New Jersey Railroad Tax Act, N.J.S.A. 54:29A-1 *et seq.* The unpaid principal and interest is fully secured by a paramount lien on all of the debtor's assets in New Jersey. N.J.S.A. 54:29A-54. The claims are administration claims, with clear priority. In exchange for these fixed, fully secured, high priority claims, the State is to receive "delayed and therefore discounted" payment. *United States* v. *Key, supra,* 397 U.S. at 334 (Douglas, J., concurring). The statutory obligation to pay the real estate taxes has been substituted by payment in securities which are a contingent obligation of the reorganized company backed by the uncertainties of recovery in a law suit.

The securities applied to payment of the State's franchise taxes are similarly "secured." The securities bear interest at only 8% per annum.* Plainly, these lost rights are of value. The State is entitled to full compensation for the entire bundle of rights it is called upon to surrender. *Consolidated Rock Products Co.* v. *DuBois, supra*, 312 U.S. at 527-528. The plan does not provide full compensation and yet lower priority creditors are to participate and receive payment under the plan.

It is to be conceded that the State's claim in this matter is not relatively large. It is to be added that other taxing authorities have accepted the treatment under the plan without objection. However, the fairness and equity of a plan of reorganization do not hinge upon either the size of a particular claim or the number of other creditors and claimants who take no exception. See *Case* v. *Los Angeles Products Lumber Co., supra*, 308 U.S. at 115. The issues presented in this case are also present in other pending reorganizations in which the State is a party. Therefore, the questions raised as to the fairness and equity of the Reading plan are substantial and far-reaching. Review should be granted by this Court.

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* The uncontradicted testimony introduced below demonstrated that the notes to be issued to the State would have to bear interest of at least 11% to compensate for the delay and uncertainty in payment (Transcript 9/17/79: T157-18 to T157-23).

POINT III

The approval of the plan of reorganization represents the exercise of congressionally delegated power in a fashion that impairs the State's integrity and its ability to function effectively in a federal system which is contrary to the Tenth Amendment of the Constitution of the United States.

In *National League of Cities* v. *Usery,* 426 U.S. 833 (1976), the Court recognized that the Tenth Amendment to the Constitution of the United States

> "... expressly declares the constitutional policy that Congress may not exercise power in a fashion that impairs the States' integrity or their ability to function effectively in a federal system." *Id.* at 843, quoting from *Fry* v. *United States,* 421 U.S. 542, 547 n.7 (1975).

The limitation upon the exercise of expressly delegated powers is premised upon the principle that there are attributes of sovereignty attaching to each state government which may not be impaired by Congress. In striking down the amendments to the Fair Labor Standards Act which extended the Act's minimum wage and maximum hour provisions to almost all employees of state and local governments, the Court concluded that the exercise of the commerce power was beyond the power of Congress. The amendments served "to directly displace the States' freedom to structure integral operations in areas of traditional governmental functions." *Id.* 426 U.S. at 852.

That states have the sovereign right to assess and collect taxes for the support of the state governments is indisputable. See *International Harvester Co.* v. *Wisconsin Dept. of Taxation,* 322 U.S. 435, 441-445 (1944). The State

of New Jersey's sovereign right of taxation was suspended by the reorganization court when it entered its tax payment deferral order in July of 1972. The State was further enjoined from taking any action to compel payment of its taxes. The exercise of such an implied power under Section 77 of the Bankruptcy Act represented a fundamental intrusion upon the sovereignty of the State. The policy determination reflected by this decision compelled the State to either raise other revenues to support its existing services or to scale back its services. The State was compelled, further, to extend its protection and benefits to the debtor and its property, including police and fire protection, during reorganization without payment of any of the taxes to support these services.

The plan of reorganization approved below compounds the initial impairment of State sovereignty and represents a continued displacement of State policy choices of how its funds should be employed. Under the approved plan, the State is compelled to invest its funds in speculative securities of a private enterprise. The reorganization court rejected the State's contention that the plan represented an exercise of the bankruptcy power of Art. I, § 8, par. 4 beyond the power of the federal government, reasoning that the amount of the State's claim which is to be deferred was not large enough to impose changes on the conduct of integral State functions. This Court, in *National League of Cities* v. *Usery*, made clear that the financial impact of the exercise of federal power was not determinative. Rather, the issue is whether or not the State's ability to exercise its sovereign power and its ability to make its own policy determinations regarding integral State functions has been displaced by federal action. *Id.* 426 U.S. at 853.

The displacement of the State's policy choices as to how the State will employ its tax revenues as reflected in the

payment provisions of the Reading plan are clear. The State is again told, as it was told in 1972 when the tax payment deferral order was initially entered, that taxes legally owing to it are to be retained and put to use by the Reading Company. The State is compelled to invest its money in the reorganized company. Such an exercise of the bankruptcy power, under authority conferred by the Congress, enforced by a federal court, is violative of the Tenth Amendment. The Third Circuit's conclusion that the approval of the plan of reorganization does not exceed the power of the federal government is contrary to *National League of Cities* v. *Usery, supra.* This conflict requires review by this Court.

CONCLUSION

It is respectfully submitted that for the foregoing reasons, the petition for writ of certiorari should be granted.

Respectfully submitted,

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[APPENDICES FOLLOW]

APPENDIX A

Opinion Re: Approval of the Plan of Reorganization of the United States District Court for the Eastern District of Pennsylvania

IN THE

UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF PENNSYLVANIA

In Proceedings for the Reorganization of a Railroad
Bky. 71-828

IN THE MATTER

OF

READING COMPANY

Debtor

OPINION RE APPROVAL OF THE PLAN OF REORGANIZATION
DITTER, J.

May 21, 1980

HISTORY OF THE READING RAILROAD REORGANIZATION

Once the largest corporation in the world, the power and financial base of the Reading Company has eroded steadily since the demand for rail as a form of passenger and freight

transportation diminished. Reading's income fell short of its expenses and finally, on November 23, 1971, it filed for reorganization under section 77 of the Bankruptcy Act, 11 U.S.C. §205, thus becoming a part of the nation's rail crisis which eventually found seven other major railroads in the northeast and midwest seeking reorganization.

At the time of bankruptcy, Reading had a yearly operating income loss of $5.7 million and a net ordinary loss of $11.5 million. Order No. 1 stayed the payment of taxes, rents to leased lines, and proceedings by creditors against the railroad for suits stemming from the operation of trains. In 1972, the net operating loss increased to $12.1 million and the net ordinary loss to $20 million. In 1973, the situation slightly improved in that the net operating loss totaled $8.7 million and the net ordinary loss was $12.7 million. These gloomy financial statistics for Reading as well as the other bankrupt northeast and midwest railroads, coupled with the great public need for continuing rail service and the enormous inherent value of the railroads provoked Congressional action to preserve an operating rail system.[1]

Intervention came by way of the Regional Rail Reorganization Act of 1973 (RRRA), 45 U.S.C. §§701-94. Essenti-

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[1] On June 15, 1973, the trustees filed a preliminary Plan of Reorganization for Reading which presented two alternative solutions: public sector intervention through federal legislation or liquidation of the railroad. They hoped for federal rail legislation by the summer of 1973; otherwise, the trustees contemplated submitting a definitive reorganization or liquidation plan on or before November 23, 1973. This date was subsequently extended by Order No. 495. Finally, on January 2, 1974, the Regional Rail Reorganization Act of 1973 was signed into law.

ally, the RRRA set up a plan for conveying the operating assets of the bankrupt railroads to a new corporation created by the Act, the Consolidated Rail Corporation (ConRail), 45 U.S.C. §741-47. Pursuant to the RRRA the bankrupt railroads would continue to operate under their respective reorganization courts for twenty months. During that time, the newly formed United States Railway Association (USRA), see 45 U.S.C. §711, was to plan which parts of the rail system were to be conveyed to ConRail. The bankrupt railroads were to receive ConRail securities[2] in exchange for the conveyance of their operating rail assets. A three-judge "Special Court" was created to rule on the valuation of the conveyed property. See 45 U.S.C. §§719 and 743.

Before the Reading would be subject to the RRRA, I had to find that it was not reorganizable under section 77, or, if it was, that the public interest would be better served by reorganization under the RRRA rather than under section 77. See 45 U.S.C. §717(b). I concluded that the Reading Company was not reorganizable on an income basis within a reasonable time under section 77 and thus, was eligible to be reorganized under the RRRA. *In re Reading Company,* 378 F. Supp. 474 (E.D. Pa. 1974). As required for the RRRA to apply, 45 U.S.C. §717(b), I also found that it provided a process which was 'fair and equitable" to the Reading's estate. *In re Reading Company,* 378 F. Supp. 481 (E.D. Pa. 1974).

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[2] Although the Act provided for the issuance of ConRail securities at conveyance, 45 U.S.C. §§719 and 743, they have been withheld pending the outcome of the litigation to determine exactly how much is due.

Appendix A

The USRA formulated a planning package for the conveyance to ConRail. A preliminary system plan was filed on February 27, 1975, and a final system plan on July 26, 1975. On April 1, 1976, the Reading's rail assets described in the final system plan were conveyed. The remainder of the estate then consisted of real property, a trucking company, some marine equipment, other investments, and the probable proceeds from the valuation case before the Special Court.

SUMMARY OF THE PLAN

Fundamental to any bankruptcy is the reality that all creditors cannot currently be fully paid in cash. Thus, principles of priority or structuring of creditors are used in a plan of reorganization so that preferred or senior creditors receive a proportionately better share than others.

The standards for approval of any priority system under a plan involve a determination that the creditors will be justly compensated in accordance with the fifth amendment, that pursuant to 11 U.S.C. §205(e)(1) the plan is "fair and equitable" and affords "due recognition to the rights of each class of creditors and stockholders," and that the plan complies with the judicially created absolute priority rule.

> Under the absolute priority rule, a plan is not "fair and equitable" unless it provides participation for claims and interests in complete recognition of their strict priorities, and unless the value of the debtor's assets supports the extent of the participation afforded each class of claims or interests included in the plan. Any arrangement by which a junior class receives values allocable to a senior class "comes with-

> in judicial denunciation." Beginning with the topmost class of claims against the debtor, each class in descending rank must receive full and complete compensation for the rights surrendeed before the next class below may properly participate. ((footnotes omitted)

In re Penn Central Transportation Co., 596 F. 2d 1102, 1110 (3d Cir. 1979) quoting 6A *Collier on Bankruptcy* ¶11.06, at 210-11 (14th ed. 1977).

Additionally, the reorganization court must conclude that the plan is feasible, that is, that the new corporation will have enough income to meet is expenses, 11 U.S.C. §205 (b)(4).

The present assets of the estate consist of approximately $25 million in cash, between $35 and $45 million in real estate and other investments not conveyed to ConRail,[3] and a potential recovery in excess of $200 million from the valuation case. Under the Plan, many of these retained assets will be liquidated in a very detailed manner. The liabilities of the estate are estimated to be $165 million excluding the fees and expenses of the reorganization. Even though the amount of proceeds, if any, from the valuation case will not be determined for years, the trustees believe that the time is ripe for reorganizing the Reading estate. The retained assets and the problems relating to them are identified. An organization has been created to maximize the return on the retained investments and to liquidate

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[3] Certain claims being litigated may add substantially to the estate. Of course, Reading may also be unsuccessful in them. See Order No. 1392 as to Trailer Train Company and Order No. 1448 as to Blythe Township.

as rapidly as possible retained assets which will not be used by the reorganized company. The Plan of Reorganization has been devised to establish a feasible capital structure and to propose a fair and equitable method of distribution. In this Plan, the estimated value of the corporation's retained assets is co-ordinated with the unknown value of the proceeds of the valuation case. This involves issuing securities based on the outcome of the valuation case, and satisfying various classes of creditors with combinations of cash and securities. The distribution of securities in lieu of cash satisfies the absolute priority rule. *In re Penn Central Transporation Co., supra*, 596 F. 2d at 1110-11 (3d Cir. 1979).

Generally, a reorganization plan must provide for the claims of administration (expenses of conducting ongoing operations during bankruptcy), secured claims, unsecured claims, and equity interests. However, it is only after satisfaction of the creditors' claims that the stockholders or equity interests are considered. The classification of claims is within the purview of section 77(c)(7) of the Bankruptcy Act, 11 U.S.C. §205(c)(7) which provides in relevant part:

> (7) The judge shall promptly determine and fix . . . for the purposes of the plan and its acceptance, after notice and hearing, the division of creditors and stockholders into classes according to the nature of their respective claims and interests. Such division shall not provide for separate classification unless there be substantial differences in priorities, claims, or interests.

The Reading Plan is structured around eight categories of claimants with various securities being issued to satisfy

the debts in each category. The Class A claims include compensation for the trustees and their counsel and costs and expenses incurred in connection with the Plan and reorganization proceedings under sections 77(c)(2) and 77 (c)(12). These claims have the highest priority and will be paid in cash at consummation or paid in the ordinary course of business.

Class B claims are those of the federal government arising from loans made to ConRail under section 211(h) of the RRRA for payment of Reading's administrative claims during the pre-conveyance, post bankruptcy period and from trustees certificates issued to the United States. These claims will be paid by issuance and delivery of Series A administrative notes, having the highest priority.

Class C claimants include state and local taxing authorities which have not settled prior to the Plan's consummation. Their claims will be partially satisfied in cash and partially in Series B administrative notes which are contingent upon the Reading's receiving additional compensation for the valuation case.

Class D claims consist of other administrative claims which are not reorganization expenses paid at consummation. These debts will be settled in an administrative claims settlement program prior to consummation or will be paid in Series C administrative notes.

Class E claimants are railroads which provided materials and services to the Reading Company six months prior to the petition for reorganization, here prior to May 22, 1971. Traditionally they have been given a higher priority than secured claims since these railroads serviced the Reading, cognizant of its poor financial condi-

tion, so that the public transportation system could operate. These six-month creditor claims will receive five percent cash on consummation and 95 percent Series C administration notes.

Class F is comprised of secured creditors holding mortgage bonds. The government guaranteed loans, secured by Series E bonds, will receive cash for a portion of the unpaid interest on the secured claim as of consummation date plus five year Series A bonds paying interest at ten percent to satisfy the accrued but unpaid interest obligation. The principal portion of the claim will be paid by issuing Series C-2 bonds bearing interest at eight percent. Present Series D bondholders will receive cash for a portion of unpaid interest accrued plus six year Series B bonds paying interest at ten percent to satisfy the balance of the accrued but unpaid interest obligation. The principal will be paid by issuing Series C-1 bonds bearing interest at eight percent.

Class G or unsecured creditor claims include pre-bankruptcy personal injury claims and unsecured creditor claims. Personal injury claims will be paid in cash in three equal installments on the Plan's consummation date and on the first and second anniversaries of that date. Other unsecured creditors may choose between a cash settlement equal to 15 percent of their allowable claim and a promissory note in an amount equal to the principal of their claim bearing eight percent interest and payable on April 1, 1988, or 90 days after liquidation of the proceeds of the valuation case, whichever is earlier.

Class H claims involve stockholder's equity. All stockholders shall receive a percentage of stock in the new company equal to the percentage which they held of the

aggregate of all preferred and common stock in the old company.

NEW SECURITIES AND THEIR DISTRIBUTION

The Plan provides for the issuance of three types of administrative notes: A through C; four series of reorganization bonds: A through C-2; two types of unsecured creditor notes; and new common stock. The administrative notes, unsecured creditor notes, and reorganization bonds will be secured by mortgage indentures. A description of the new securities detailing the schedule of payment and the rights of the holder is essential to an understanding of the Plan.

1. Series A Administrative Notes

Approximately $31 million in Series A notes will be issued to satisfy the United States government's section 211(h) and trustee certificate claims. These notes will have the highest lien priority and right of payment. The interest rate will be eight percent, compounded annually with accrued interest to be paid at redemption of the notes. They will be due on April 1, 1988, or 90 days after liquidation of all or part of the valuation case proceeds.

2. Series B Administrative Notes

The payment of Series B securities will be contingent upon the estate's receiving compensation from the valuation case in excess of the amount allocated to the Reading under the final system plan. An estimated $7½ million in Series B notes have or will be issued in partial satisfaction of state and local real estate cliams. Interest

at eight percent will be compounded annually with accrued interest to be paid at redemption of the notes. They will be due 90 days after liquidation of all or part of the valuation case proceeds. A lien on any additional compensation awarded by the Special Court will serve as security for these notes.

3. Series C Administrative Notes

Administrative claims other than reorganization expenses (which will be paid fully in cash on consummation) will be satisfied by Series C administrative notes. Interest at eight percent on these notes will be compounded annually but payment will be deferred until maturity or redemption. They will be due on April 1, 1988, or 90 days after liquidation of all or part of the valuation case proceeds. The Series C notes will be secured by a lien on the retained assets, assest disposition proceeds, and the valuation case proceeds.

4. Reorganization Bonds

Reorganization bonds in various combinations will be issued to satisfy the Reading's secured creditors—the holders of the 1945 mortgage bonds and government guaranteed loans.[4] These bonds will be secured by a mortgage

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[4] The secured creditor claims stem from two issues of mortgage bonds secured by the same mortgage on Reading's property, the 1924 mortgage administered by Manufacturers Hanover Trust Co. The two issues of mortgage bonds are the Series D, 1945 mortgage bonds, of which $54,070,000. face amount of bonds is outstanding, and the Series E, 1963 mortgage bonds, of which the entire face amount of the issue, $37,500,000 remains outstanding. The 1963 mortgage bonds were issued to secure the government guaranteed loan of which Debtor still owes $23,198,450. in principal.

lien on all the assets of the reorganized company. The bonds will be junior in right of payment and lien priority to the series A and C administrative notes with respect to the retained assets, asset disposition proceeds, and valuation case proceeds and junior to the Series B administrative notes with respect to any additional compensation allowed by the Special Court. The Series A and B bonds are senior to Series C bonds in right of payment and lien priority.

The Series A and B bonds will be issued to satisfy the accrued but unpaid interest as of the Plan consummation date on the government guaranteed loan and the 1945 mortgage bonds, respectively. The Series A issues will be five year bonds which will bear interest at ten percent. One fifth of these bonds will be redeemed each year commencing with the first anniversary date of consummation. The Series B issues will be six years bonds with interest at ten percent. One-sixth of these bonds will be redeemed each year commencing with the first anniversary date of consummation. The interest on both issues will be paid currently. If the necessary cash to pay principal and interest on Series A and B bonds is unavailable, such payments will accumulate and be paid when sufficient asset disposition proceeds become available.

Series C bonds will be issued in consideration for the unpaid principal on the 1945 mortgage bonds and the government guaranteed loan. These bonds will mature on April 1, 1988, or 90 days after liquidation of all or a part of the valuation case proceeds. They will bear eight percent simple interest which will be due and payable only when the bonds mature or are redeemed. At any time prior to maturity and at the reorganized company's option, Series B bonds will be redeemable with accrued inter-

est, on a pro rata basis, so long as administrative notes and bonds with a higher maturity have been paid off. The Series C-1 bonds will be issued to satisfy claims for the unpaid principal obligation of the Series D, 1945 mortgage bonds. The Series C-2 bonds will be issued to satisfy the unpaid principal obligation of the government guaranteed loan. The right of payment and lien priority are the same for the Series C-1 and C-2 bonds; however, only the holders of Series C-1 bonds will be entitled to vote for directors of the reorganized company.

5. Unsecured Creditor Notes

Two types of notes will be issued to unsecured creditors: one for personal injury claimants and the other to unsecured creditors. The personal injury notes[5] will not bear interest and will be redeemable and mature one-half on the first anniversary of the Plan consummation date and one-half on the second anniversary. The unsecured creditor notes will bear interest at eight percent simple interest, and will also be secured by mortgage liens on all the retained assets, asset disposition proceeds, and valuation case proceeds. All principal and interest on these notes will be due on April 1, 1988, or 90 days after the liquidation of the valuation case proceeds, whichever is earlier.

The unsecured creditor notes are junior in right of payment and lien priority to the administrative notes and re-

[5] These notes will constitute two-thirds of the personal injury claims. The first one-third will have been paid in cash at consummation of the Plan. These provisions were part of a compromise reached with the United States.

organization bonds but senior to any dividends on new common stock. Personal injury notes are senior in right of payment to the unsecured creditor notes.

6. New Common Stock

The reorganized company's articles of incorporation will authorize 10,000,000 shares of new common stock of which 2,795,291 shares will be issued on the Plan consummation date. The stock will have a par value of one cent and will not have preemptive rights. Each share will entitle the holder to one vote at shareholders' meetings but the stock cannot be cumulated for voting in any manner.

7. Mortgage Indentures

The mortgage indentures will secure the administrative notes and reorganization bonds as well as provide liens securing obligations on all of the assets of the reorganized company. There is one exception: Series B administrative notes will be only secured by a lien on any additional compensation allowed by the Special Court in the valuation case and will be subject to the prior lien of the Series A administrative notes.

The indentures will provide that once the expenses of operation and maintenance have been met, the certificates of value and any additional proceeds from the valuation case and from the asset disposition program will become security for and may be applied to the payment of the obligations of the reorganized company. Any such payments will be free and clear of the liens and encumbrances of higher priority creditors. The mortgage indentures will restrict the ability of the reorganized company to create

liens and incur or assume additional indebtedness except in the ordinary course of busness and under the conditions specified by the terms of the indentures.

MAJOR COMPROMISES

In a plan such as the Reading's which is primarily consensual, the importance of compromise cannot be overemphasized. Many settlements have laid the foundation for the Plan, and the Plan itself is the product of many hours of negotiation. Before describing the various compromises between the major claimants of the estate, some understanding of the presumptions upon which the settlements rely is necessary.

No settlement would be possible without the claimants' agreeing to defer the major portion of the debt until the valuation case proceeds, the largest single asset of the estate, can be used for payment. The valuation case is the ongoing litigation to determine how much money the government owes Reading for the conveyance of its operating assets to ConRail. Under the RRRA, the USRA placed a value on all of the operating assets of the estate in the final system plan. Following the example of the other bankrupt railroads, Reading and its subsidiaries did not accept as the value of their operating assets the $32 million fixed by the USRA. Instead, the Reading began to litigate the issue de novo in the Special Court set up by the RRRA. My learned colleague, Judge Fullam, has already detailed the issues in the valuation case, and I need not repeat his scholarly analysis here. *In re Penn Central Transportation Co.*, 458 F. Supp. at 1270-76 (E.D. Pa. 1978). I agree with Judge Fullam's estimation that the railroads should be optimistic about recovering a value in excess of the amount proposed

by USRA for their assets. *Id.* at 1274. Indeed, the SEC in evaluating the Penn Central plan stated: "The expectation of a large recovery from the valuation case is not a matter of contingency or unfounded hope. It is as certain as any event can be." SEC Report at 43. The Third Circuit noted that the Special Court characterized the government's initial offer of payment for the railroad's conveyed properties as "incredible." *In re Penn Central Transportation Co.*, 596 F. 2d 1155, 1165 (3d Cir. 1979).

The exact amount of recovery, however, is wholly speculative. Under an "alternate scenario," in which the trustees attempt to show what would have happened to their assets without the RRRA,[6] Alfred W. Hesse, Jr., current president of the Reading Company, speculates that it would have received in excess of $328 million. Under the formula suggested by the Special Court in its October 12, 1977, opinion—original cost less depreciation, rehabilitation, and adaptation costs—the Reading should receive approximately $215 million. See, affidavit of Alfred W. Hesse, Jr., ¶10, filed August 16, 1979. Although there is a risk that the Reading will not recover a sizeable amount in the valuation case, chances for recovery seem excellent, and claimants which are to receive a percentage of the proceeds of the valuation case as part of the Plan should be fairly certain of some payment. Thus, the consideration of possible valuation case proceeds as a means to satisfy claimants under the Reading Plan is realistic, reasonable, and fair.

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[6] The "alternate scenario" is part of the testimony in the valuation case presently before the Special Court in which Reading attempts to show that it could have sold at least part of its rail properties to profitable carriers or public bodies for rail use at prices far higher than those determined by the USRA. See, affidavit of Alfred W. Hesse, Jr., filed August 16, 1979.

Appendix A

The method for evaluating compromises in a railroad reorganization has already been well articulated by Judge Fullam. *In re Penn Central Transportation Co.*, 458 F. Supp. 1234, 1261-64 (E.D. Pa. 1978). Basically, two types of compromises are incorporated into a plan of reorganization: settlements agreed to by the concerned parties and already approved by the court apart from the plan and compromises suggested by the trustees in the plan itself without the imprimatur of those involved in the dispute. Both kinds of compromises must be examined in the same way by the reorganization court. As Judge Fullam noted, "[i]t is firmly settled that a Plan may be approved which embodies compromise resolution of conflicting contentions, if the approval is based upon an informed evaluation of the strengths and weaknesses of the respective contentions, the likelihood, duration, and expense of litigation which would otherwse be necessary, and the range of possible litigation results." *Id.* at 1261.

In assessing the reasonableness of each individual settlement, it is crucial to remember that these pieces are combined into one plan of reorganization. This unit cannot be disturbed without damaging the intricate balance established through extended negotiations. The treatment of one class of claimants must be examined in light of the overall Plan.

The power of the reorganization court to approve a plan embodying compromises does not mean that objections are ignored. On the contrary, the objections to the Reading Plan were carefully considered. However, no one involved in the Reading reorganization has advocated that the Plan should be totally abandoned unless the wishes of its class are met. The approval of the Plan necessarily entails the sacrifice of some individual demands. For the

reasons expressed in the following sections, I conclude that the individual compromises incorporated into the Reading Plan satisfy the test of fairness and equity and are within the range of possible and reasonable litigation results.

1. United States claims

The main compromise which makes all other agreements possible is the waiver by the United States of its first priority claim to which it is legally entitled under section 211(h). 45 U.S.C. §721(h), Transcript of hearings on the Plan 9/17/79 pp. 5-7.[7] Section 211(h) amended the RRRA

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[7] Section 211(h)(4)(D):

> (D)(i) Except as provided in clause (ii) of this subparagraph, any funds held in an escrow account by a railroad in reorganization on October 19, 1976, which are thereafter determined to be cash and other current assets of the estate of such railroad in reorganization for purposes of paragraph (3) of this subsection, shall be applied as follows—
>
> (I) first, to the reduction of any outstanding loans to the Corporation by the Association, pursuant to paragraph (1) of this subsection, the proceeds of which were used to discharge obligations of such railroad in reorganization;
>
> (II) second, to the Association to the extent of any such loans which have been forgiven pursuant to paragraph (5) of this subsection; and
>
> (III) third, to the payment of any remaining obligations of such railroad in reorganization, in accordance with the provision of the agency agreement entered into pursuant to paragraph (2) of this subsection.

(Footnote continued on following page)

to allow the bankrupt railroads to borrow money from the government through ConRail to pay necessary pre-conveyance expenses. In return, the Reading had to recognize the loan as a current administrative expense and provide that full repayment would have a priority superior to any other claims. Congress granted this "superpriority" since the government made railroad service possible during bankruptcy. If the United States asserted its priority and insisted on cash, there would be no available funds for any other claimants. Obviously, the decision of the United States to accept Series A administrative notes instead of cash is not challenged by any claimant.

Currently, Reading owes the United States approximately $4.8 million plus interest for a loan to purchase 57 locomotives and approximately $19 million plus interest for advances under the section 211(h) loan program. The total amount owing the government in this first priority

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(Footnote continued from preceding page)

(ii) The manner of disposition set forth in clause (i) of this subparagraph shall not apply with respect to a railroad in reorganization if the Secretary (I) determines that a different disposition of assets is necessary to carry out a reorganization plan of such railroad in reorganization, and that such different disposition adequately protects the interest of the United States, and (II) transmits his determination to the court having jurisdiction over the reorganization of such railroad.

45 U.S.C. §721(h)(4)(D).

class is estimated to be over $31 million. Exhibit B to the Plan.[8]

A condition to the United States' approval of Reading's Plan of Reorganization was the payment of $5 million in cash to the government. However, the United States agreed to waive this payment if the trustee could draw down cash for the payment of about $5 million in section 211(h) eligible claims. I authorized such a payment in my opinion and Order No. 1772.

After careful review of the treatment of the United States under the Plan, I conclude that the provisions for the United States' claims are fair and reasonable.

2. Claims by Other Railroads

(a) Leased Lines

Reading had a 999 year lease with the Philadelphia, Germantown, and Norristown Railway Company and its wholly-owned subsidiary, the Plymouth Railroad Company. The Reading also had shorter leases, 990 years, with the Delaware and Bound Brook Railroad and the North Pennsylvania Railroad Company. In anticipation of conveyances in 1976, settlement negotiations were commenced between Reading and its leased lines. Under the terms of all of these settlements, the trustees were to give a substantial cash advance to the leased railroads and take re-

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[8] This excludes a disputed $891,801 of section 211(h) drawdowns by ConRail to pay Debtor's retired employees' single premium life insurance premiums. All these amounts owing the government will be satisfied in the highest priority Series A administrative notes.

sponsibility for all real estate taxes up to the date of conveyance. In exchange, the leased lines promised to share equally with the Reading in the proceeds of any recovery for operating assets conveyed to ConRail or for nonoperating assets sold to others. Reading also agreed to manage the retained, nonoperating properties for a fee. The settlements included the forgiveness of claims for delinquent rent and the mutual release of all claims. See Hearing Order Nos. 1096, 1097, 1098. I approved these settlements with the leased lines on July 27, 1976. See Order Nos. 1126, 1127, 1128. In respect to the Plan, Reading does not owe any money to the leased lines. However, the interest of the Reading in any proceeds which the leased lines will receive from the valuation case will be considered part of the Reading's valuation case proceeds available for distribution to its creditors. I conclude that this treatment of the leased lines is fair and reasonable.

(b) Six month and Interline Creditors

Objections to the Plan of Reorganization were originally filed by Erie Lackawanna, Lehigh Valley, Penn Central, and the Committee for Interline Railroads. These claims for payment accrued primarily from per diem and interline accounts for joint use of railroad equipment and track. However, none of these objectors made statements in the hearings on the Plan since they felt settlements were imminent. As expected, the Erie Lackawanna and the Reading signed an agreement on February 13, 1980, which provided for mutual releases of all claims, except those involving personal injuries, upon Reading's payment of $30,007.23 to the Erie Lackawanna. Also, the Erie Lackawanna by letter to the court withdrew its earlier objec-

tions to the Plan. In March, 1980, the Penn Central, Lehigh Valley, and the Committee for Interline Railroads submitted stipulations for my approval of settlements. These agreements dealt with various classes of claims: pre-petition/six months creditors,[9] post-petition/pre-conveyance debts, and other post-petition claims.

Reading owes Penn Central approximately $640,000. in pre-petition claims. Under the agreement I approved, half of them were deemed Class E or "six-month claims." On consummation five percent of their total will be paid in cash and 95 percent in Series C administrative notes. The other half were deemed general creditor claims and will be secured by an indenture lower in priority and payment than administrative notes and reorganization bonds.

Reading's post-petition, pre-conveyance debts to Penn Central total $1,828,998. These claims fall within section 211(h) eligible,[10] administrative claims. The settlement

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[9] Judge Fullam described in detail the prerequisites for this six month priority in his *Penn Central* opinion, 458 F. Supp. at 1319-28.

> Before any right to priority under the six months rule can be established, it must appear that the obligation was incurred as an expense of current operations, in the ordinary course of business, for materials or services used in the operation of the railroad, that the creditor expected to be paid out of the current operating receipts of the railroad (as distinguished from reliance upon the general credit of the railroad); and that the claim arose within six months before the filing of the petition.

Id. at 1321.

[10] These post petition, pre-conveyance claims are primarily interline freight claims eligible under section 211(h)(iii). See 45 U.S.C. §721(h)(iii).

allows for an immediate payment of one-third cash and two-thirds cash held in escrow with payouts on the first and second anniversaries of the settlement's approval.

The status of the post-petition Penn Central trust fund claims is still being negotiated and a final agreement on these items will be presented to me for independent approval apart from the Plan.

The stipulation of settlement with Penn Central was approved as fair and equitable on May 21, 1980. See Order No. 1803. Thus, the objections of Penn Central to the Plan were withdrawn.

The Lehigh Valley Railroad had a post-petition, preconveyance interline freight claim of $838,447.18 against the Reading which falls within the section 211(h) eligible, administrative category. The settlement provided for the cash payment of one-half of the total claim on October 15, 1979, with the rest to be escrowed and paid out with interest on October 15, 1980. See Order No. 1803, and, consequently, Lehigh Valley's objections to the Plan were resolved.

The Committee of Interline Railroads (Interlines) is a group of approximately 76 railroads which transported freight and passengers, exchanged cars, and performed other services with and for Reading. It has both pre-petition and post-petition claims, amounting to $2.1 million and $187,000. respectively. The settlement provides that one-half of the pre-bankruptcy claims will be classified as Class E, entitled to receive five percent cash on consummation and the balance in Series C administrative notes. The other half of the pre-petition amount will be considered an unsecured creditor's claim and satisfied as such.

The post-petition Interline claims were eligible for satisfaction through section 211(h) loans. I previously authorized their payment once adjustments have been made under the appropriate Association of American Railroad Rules, in such amounts as are then determined to be due. See Order No. 1772.

I found this Interlines settlement fair and equitable on May 21, 1980. See Order No. 1803. Thus, the objections of the Interlines to the Plan were withdrawn.

One other railroad claim matter should be mentioned. Certain obligations are still outstanding between Reading and ConRail with negotiations still in progress. The amounts in issue are not so great as to upset the Plan. Therefore, whether an agreement is reached or some adjudication is required, the approval of the Plan need not be delayed.

STATE AND LOCAL TAX CLAIMS

1. Description of Claims

At one time Reading was faced with approximately $10.2 million in state and local real estate tax claims, $6.6 million in corporate state tax claims, and $263,000. in other tax claims. Since 1978, Reading has reached settlements with various taxing authorities until only $938,000. in real estate taxes and $37,000. in corporate taxes presently remain unresolved. Among the principal outstanding tax balances is New Jersey's franchise and real estate tax claims estimated to be $255,000.

When the hearing on the Plan was held, the Commonwealth of Pennsylvania joined New Jersey in objecting to

the Reading's treatment of tax claimants. After much negotiation, Reading and the Commonwealth agreed upon a basis to settle all of the Commonwealth's taxes. Under its terms, the Commonwealth would forgive $1 million in taxes, and the Reading would pay $7 million to satisfy the balance of $6.4 million in Class D state and corporate taxes and approximately $1.6 million in Pennsylvania Utility Realty Taxes, 30 percent in cash and the rest in securities. After hearing, I approved this settlement as fair and equitable. See Order No. 1794.

The bulk of Reading's other tax obligations had been for real estate taxes owing to state and local governments. A major settlement for $6.5 million with the City and School District of Philadelphia involved payment of 30 percent of the claim in cash and 70 percent in Series B notes. After hearing, I approved this agreement as fair and equitable and directed the Reading to offer the same terms to settle the remaining real estate claims. See Order No. 1519; *In re Reading Company,* 463 F. Supp. 528 (E.D. Pa. 1978). At present approximately 80 taxing authorities have settled $2.9 million in claims against the Reading on terms similar to that of Philadelphia. The Plan utilizes this same 30 percent cash/70 percent securities package to pay the remaining tax claimants. The State of New Jersey has consistently objected to the Philadelphia agreement and the Plan's treatment of state and local tax claims.

2. Objections of New Jersey

The state of New Jersey objects to the Plan on many grounds (1) failure to provide for prompt cash payment as statutorily required for administrative tax claims; (2) failure to recognize and provide for interest at the statu-

tory rate on unpaid administrative tax claims through consummation; (3) inclusion of non-real estate tax claims in the same class for voting as other administrative claims; and (4) construing tax claims which have settled as voting for approval of the Plan.

New Jersey argues that its administrative tax claims must be satisfied in cash instead of the Plan's provision of 30 percent in cash and 70 percent in securities. New Jersey contends that 28 U.S.C. §960 and section 77(e)(3) of the Bankruptcy Act, 11 U.S.C. §205(e)(3), mandate cash payment of current taxes unless exceptional circumstances exist.

I found the necessity for the continued operation of the railroad sufficient justification to defer tax payments soon after the Reading filed its petition for reorganization. See Order No. 186. A similar deferral of taxes was allowed in *Penn Central* as necessary to the maintenance of a railroad system operating at a loss for the public good. *In re Penn Central Transportation Company,* 325 F. Supp. 294 (E.D. Pa. 1970) aff'd 452 F. 2d 1107 (3d Cir. 1971) cert. denied *New Jersey* v. *Penn Central Transportation Company,* 406 U.S. 944 (1972).

New Jersey interprets the Third Circuit's approval in *Penn Central* as mandating that the tax deferral be temporary and be terminated at the earliest possible date. New Jersey contends that the Plan's provision of 70 percent in Series B notes defers payment until the Special Court determines whether any additional compensation will be owing pursuant to the valuation case. The earliest projection for completion of the valuation case is 1988.

The Reading trustees counter that notwithstanding the deferral of taxes pursuant to Order No. 186, the Reading has paid New Jersey a substantial portion of its real estate tax claim. Of the $600,000. once claimed by New Jersey, Reading has paid approximately $350,000. The trustees argue that a continued deferral of the remainder is proper since the conveyance to ConRail included properties upon which tax liens were assessed. The conveyance was free and clear of those liens, which were then transferred to the proceeds of the sale, that is, to the valuation case, and New Jersey must look to those proceeds for payment. Judge Fullam in his *Penn Central* opinion aptly summarized the complex problems involving tax claims.

> The impact of [the Rail Act] upon the status of the claims for state and local taxes, and upon the relationship between these claims and the claims of other creditors, cannot be overemphasized. Because continuation of loss operations was mandated, the amount of unpaid tax claims and other unpaid administration claims was greatly increased, probably by more than half a billion dollars in the aggregate. At the same time, the rights which such claims would have on liquidation (which is the standard for assigning 'value' to all claims in the present context) were significantly altered; moreover, the nature and extent of this alteration could well provide the grist for many years of litigation . . .
>
> The liquidation rights of the tax claimants in the present circumstances are quite different. In the first place, the properties against which roughly three-fifths of the tax claims are assessed have been conveyed to ConRail free and clear of all liens, in-

> cluding tax claims. With respect to pre-petition taxes, this means that the liens are transferred to the proceeds to be derived from the Valuation Case; but realization from that source is deferred and uncertain. With respect to post-petition taxes, the problem is one of the proper allocation of administration expenses. That is, it cannot be assumed that post-petition taxes, even though they are administration claims, would be satisfied promptly by retained assets, in the event of liquidation. Assuming the validity of the Government's superiority, the tax claims would not have access to cash or other liquid assets, and could not be satisfied from sales of retained assets without doing violence to mortgage liens upon retained assets. The notion that tax claims generated by conveyed assets would automatically be transferred to, and prime existing mortgages on, retained assets is one which would not likely be accepted by mortgagees without a struggle. 458 F. Supp. at 1277-78.

The Plan's treatment of tax claims by payment in cash and securities is a fair and equitable solution to these difficult problems.

New Jersey argues that section 77(e)(3) of the Bankruptcy Act requires payment of administrative claims in cash unless the claimant agrees otherwise. Section 77(e)(3) states:

> (3) the plan provides for the payment of all costs of administration and all other allowances made or to be made by the judge, except that allowances provided for in subsection (c), paragraph (12) of this section, may be paid in securities provided for in the

> plan if those entitled thereto will accept such payment, and the judge is hereby given power to approve the same. 11 U.S.C. §205(e)(3).

The trustees dispute New Jersey's interpretation of the statutory language. Reading argues that "costs of administration" refers to expenses directly associated with the reorganizatiou proceedings, such as compensation for trustees and attorneys. See *In re Penn Central Transportation Co.*, 458 F. Supp. 1234, 1282 (E.D. Pa. 1978). Deferred taxes would properly fall under "claims" in section 77(b) the rights of which may be modified by the Plan of Reorganization. I agree.

Furthermore, the trustees contend that New Jersey's interpretation requiring agreement to the Plan by every taxing authority would allow one "holdout" administrative claimant to destroy the carefully interwoven pattern of comprises. The reorganization court must be allowed flexibility to preserve the compromises embodied in the Plan by approving a fair and equitable treatment of administrative claims over a taxing authority's objection. Compromise is the key to a consensual Plan. The trustees point out that the United States, a creditor of the highest priority, accepted securities in lieu of cash in satisfaction of its claim. New Jersey is receiving a greater percentage of its claim in cash than any other claimant except those in Class A whose demands arise from reorganization.

New Jersey's major objection is its insistence that the word, "payment," in section 77(e)(3) of the Bankruptcy Act requires payment in cash not securities. New Jersey contends that the absolute priority rule prohibits distribution of any cash to junior claimants before tax claims are fully paid, i.e., administrative claimants may be paid in a

form other than cash only if no cash is available. I agree with the trustees that the absolute priority rule as applied to railroad reorganizations does not mandate such an inflexible policy.

The Third Circuit in *Penn Central* recognized the need for a pragmatic and flexible approach to priorities in reorganization. The court analyzed the purpose of the absolute priority rule as ensuring that senior creditors receive full compensatory treatment before the next class is allowed to participate. The Third Circuit noted the difference between determining priorities in a reorganization as opposed to a liquidation.

> First, in a reorganization the aggregate value of the debtor's assets is determined, not by a judicial sale, but by a hypothetical—albeit expert—calculation of their future worth to the enterprise. Second, claimants are satisfied not with cash, but with securities which reflect an apportionment of value in an ongoing business enterprise. It has long been recognized that these features of the reorganization process make it wholly unreasonable to expect that any plan will meet with precision the standards of the absolute priority rule. *In re Penn Central Transportation Co.*, 596 F. 2d 1102, 1110 (3d Cir. 1979).

It is clear from this analysis that the Third Circuit realized the necesesity and legality of satisfying reorganization claimants with securities. The court found support for its approach of flexibility in pursuit of feasibility in these words from the Supreme Court:

> The absolute priority rule does not mean that bondholders cannot be given inferior grades of securities, or even securities of the same grade as are

> received by junior interests. Requirements of feasibility of reorganization plans frequently necessitate it in the interests of simpler and more conservative capital structures. And standards of fairness permit it.
>
> * * *
>
> Practical adjustments, rather than a rigid formula are necessary. The method of effecting full compensation for senior claimants will vary from case to case. . . . [W]hether in a case of a solvent company the creditors should be made whole for the change in or loss of their seniority by an increased participation in assets, in earnings or in control, or in any combination thereof, will be dependent on the facts and requirements of each case. So long as the new securities offered are of a value equal to the creditors' claims, the appropriateness of the formula employed rests in the informed discretion of the court. *Consolidated Rock Products Co.* v. *Du Bois, supra,* 312 U.S. at 528-30, 61 S. Ct. at 686-87 (footnotes omitted).

quoted in *In re Penn Central Transportation Co.,* supra, 596 F. 2d at 1111 (3d Cir. 1979).

The Reading's treatment of state and local tax claimants reflects the trustees' best estimate of the real worth of the tax claims compared to the rest of the claims against the estate. Reading does not acknowledge it owes what New Jersey demands. Principally, the Reading contends that a reduction in its tax liability is warranted since the state insisted the Reading operate, even at a loss, to serve New Jersey residents. Still, the Reading proposes to satisfy the tax claimants with a significant

portion of the claim in cash and the remainder in Series B notes, high priority securities.

At the hearing on the Plan, New Jersey offered the testimony of Mr. Roland Machold, Director of the State's Division of Investments, to prove that the Series B and C administrative notes were speculative and inferior. Although these securities are based on the outcome of the valuation case, Mr. Machold had not read any of the testimony presented to the Special Court. As previously discussed, Reading's optimism for a substantial recovery from the valuation case is shared by the SEC, Judge Fullam, and Third Circiut in analyzing *Penn Central*. I conclude that the Plan's satisfaction of state and local tax claimants by 30 percent cash and 70 percent Series B administrative notes fully compensates Class C claimants under the absolute priority rule and complies with the fair and equitable requirement of section 77.

New Jersey further maintains that Reading's treatment of its tax claims violates the fifth and tenth amendments to the Constitution. The State argues that any deferral of tax payment without the State's consent is tantamount to a requisitioning of State property, and the fifth amendment would require just compensation for such a government taking. Just compensation puts the creditor in as good a financial position as if the property had not been taken. New Jersey contends this means cash payment.

I agree with the trustees that deferral of taxes cannot be construed as a taking since it does not impermissibly impair the rights of tax claimants. Similarly, there is no constitutional requirement that administrative claims be paid only in cash. In a reorganization proceeding, satisfaction of tax claims in cash and securities is just compen-

sation. Indeed the Supreme Court held that "no decision of this Court holds that compensation other than money is an inadequate form of compensation under eminent domain statutes." *Regional Rail Reorganization Act Cases,* 419 U.S. 102, 150, 95 S. Ct. 335, 362, 42 L. Ed. 2d 320 (1974).

The tenth amendment is allegedly infringed by Reading's payment of tax claims in cash and securities since this is an impermissible intrusion by the federal government on the state's right to assess and collect taxes. New Jersey cites *National League of Cities* v. *Usery,* 426 U.S. 833, 96 S. Ct. 2465, 49 L. Ed. 2d 245 (1976), in support of this assertion. In *National League of Cities* the Supreme Court invalidated an amendment to the Fair Labor Standards Act extending minimum wage-maximum hour provisions to state and local governments. The Court held that the amendment would directly interfere with the state's exercise of its day to day function as a public employer. The Court articulated the tenth amendment standard in this way.

> Congress may not exercise that [commerce] power so as to force directly upon the State its choices as to how essential decisions regarding the conduct of integral govermental functions are to be made. 426 U.S. at 855, 96 S. Ct. at 2476.

The deferral of state taxes due to a rail reorganization does not impose changes on the conduct of integral state government functions. The entire tax claim involved here is $255,000. The Plan would allow the trustees to pay 30 percent in cash and 70 percent in securities instead of the full amount in cash as New Jersey favors. The deferral of approximately $175,000 of immediate cash payment is

hardly disruptive of the day to day functions of an entire state. I conclude that the payment of tax claims in cash and securities is not violative of the tenth amendment.

Finally, New Jersey raises several objections which I do not need to decide at this time. The State argues that the Plan fails to provide interest for its principal claim at the statutory rate. This objection can best be decided when the exact amount of all claims are adjudicated. What is presently before me is the fairness and equity of the ranking of claims and their treatment as part of one Plan.

The State's objection concerning voting procedures is similarly premature. New Jersey disapproves of tax claimants being grouped with other administrative claimants as one class for voting purposes. Also, the Plan deems those taxing authorities who have accepted the Philadelphia settlement as voting for the Plan. These contentions properly should be raised at consummation rather than the approval stage. However, I direct the trustees to keep separate lists of the votes of tax and nontax administrative claimants and the settling and non-settling tax claimants.

FEASIBILITY OF THE PLAN

In addition to determining whether or not the Plan's allocation of Reading's available assets to its debts is fair and reasonable, I must also determine whether the Plan is feasible.

Section 77(b)(4) of the Bankrutcy Act requires, in pertinent part, that a plan

> (4) shall provide for fixed charges in such an amount that, after due consideration of the prob-

> able prospective earnings of the property in light of its earnings experience and all other relevant facts, there shall be adequate coverage of such fixed charges by the probable earnings available for the payment thereof. 11 U.S.C. §205(b)(4).

Judge Fullam further articulated the standard in his *Penn Central* opinion:

> The design of the capital structure of the reorganized enterprise must be such that the Debtor's earnings will support the new capital structure. The reorganized company must be reasonably likely to be able to comply with the requirements of the securities issued. That is, it must be reasonable to suppose that the reorganized company will be able to meet when due the payments required by the new debt securities, and that it will have sufficient earnings to enable it to pay dividends and grow, so that its equity securities will have value. *In re Penn Central Transportation Company,* 458 F. Supp. 1234, 1247 (E.D. Pa. 1978).

In the historic railroad reorganization, feasibility referred to the reorganized company's ability to succeed in the railroad business. The question was whether it could generate sufficient revenues to meet its operating costs and support a pared down debt structure. The Penn Central problem was different, but analogous. Penn Central had subsidiary businesses which with proper management could be expected to yield far more through their operation than could be realized through their liquidation.

In contrast, Reading's sources of income are limited to rents, interest and dividends, and the operations of a

comparatively small coal company. A major portion of its money over the next five years will come from its assets disposition program. Reading's total receipts, however, will not provide enough to pay off its obligations—success in the valuation case is the key to the ultimate discharge of debts. Although optimism prevails about the chances of a substantial recovery in the valuation case, this will only occur if litigation efforts are diligently pursued. The present Plan does not—and cannot—provide the questions, much less the answers, as to what Reading's income and expenses will be if it acquires some sort of operating or manufacturing business. Thus, feasibility, in the present context only deals with whether projected income and the proceeds from the disposition of assets will enable it to pay its expenses, liquidate its debts on schedule, and seek a satisfactory result in the valuation case.

The sole objection as to feasibility also came from New Jersey. In itself, New Jersey's claim is minimal and it could be paid at any time. It is only important because if New Jersey is afforded the favorable treatment it wants, similar demands from other tax claimants might be provoked. If they were met,[11] the feasibility of the Plan would be jeopardized since the outflow of cash would leave nothing to fund the valuation case litigation. It is for this reason, and this reason alone, that the assertions of New Jersey have been considered so fully.

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[11] This is not to say that they would be met. Claimants who have not settled would not necessarily be governed by a decision as to New Jersey's claim. Although those tax claimants which have settled are protected by a "most favored nations" clause, it would not necessarily govern if immediate cash payment to New Jersey was ordered by the court, as contrasted to Reading's agreeing to pay New Jersey in cash immediately.

Appendix A

In support of their opinions that their Plan is feasible the trustees and their staff made various studies and projections. Their approach was to be conservative insofar as receipts were concerned and realistic about disbursements. Their forecast was attached to the Plan as Exhibit A. In summary it shows the following: (all figures are in millions)

	1980	1981	1982	1983	1984
Beginning cash balance	$25.0	$15.2	$14.6	$14.7	$13.5
Receipts:					
Operations	6.2	5.0	4.9	5.0	4.9
Asset Dispositions	6.0	6.2	4.5	1.4	1.9
Total Receipts	$12.2	$11.2	$ 9.4	$ 6.4	$ 6.8
Disbursements:					
Operations and Asset Disposition Program	$ 4.2	$ 4.2	$ 2.3	$ 2.3	$ 2.4
Plan Disbursements	17.8	7.6	7.0	5.3	5.0
Total Disbursements	$22.0	$11.8	$ 9.3	$ 7.6	$ 7.4
Net Cash Increase	$(9.8)	$ (.6)	$ .1	$(1.2)	$ (.6)

Support for these projections can be found in the affidavits of the trustees and officers of the Reading Company and their testimony given at the hearing on the Plan.

These figures show three things. Frst of all, the Reading has reasonable expectations that it will be profit-

able.[12] Secondly, there will be sufficient cash flow to meet the debt payments scheduled by the Plan, and finally, it will have sufficient reserves to prosecute matters before the Special Court. Moreover, there should be enough margin to meet the unexpected and still survive. I reiterate the obvious, however. These figures do not purport to show what will happen if Reading embarks on some new venture. Feasibility, as I use the term, refers only to what the Reading now is, now does, and now plans.

With this understanding, it is plain that the Plan provides a realistic means to pay off its debts on schedule—those in the immediately foreseeable future—and through the pressing of the valuation case, those that have been deferred.

CONCLUSION

For the reasons that have been expressed at length, I conclude that the Plan of Reorganization submitted by Andrew L. Lewis, Jr., and Joseph L. Castle, III, Trustee of Reading Company, Debtor, as amended

1) Complies with all requirements of law;

2) Is feasible; and

3) Is fair and equitable.

Two more things must be said.

First, I have been spared the necessity of re-examining and discussing many of the concepts which govern section 77 proceedings and those under the RRRA because of

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[12] Dividends will be deferred, however, until all reoragnization debts have been paid.

Appendix A

Judge Fullam's landmark opinion approving the Penn Central plan. There was no point in my repeating except for limited purposes what he had said so well and so recently. On occasion I did so, but obviously, his scholarly work was more than a source of quotations—it was a constant help and guide to my task.

Secondly, the competing interests of the contending parties are best served by a consensual plan. In many respects the compromises which have been reached were achieved through the leadership of the trustees and their staff. In addition, their management skills have provided a viable base on which compromises could be built and against which the chances of ultimate success could be measured. The trustees and their staff deserve my commendation and the thanks of all whose investments they have helped to salvage.

Appendix A

Order of the United States District Court for the Eastern District of Pennsylvania

IN THE UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF PENNSYLVANIA

IN THE MATTER

OF

READING COMPANY

Debtor

In Proceedings for the Reorganization of a Railroad

Bky. 71-828

ORDER No. 1804

AND NOW, this 21st day of May, 1980, I approve the Plan of Reorganization of the Reading Company, as amended by my Order No. 1803, for the reasons expressed in the foregoing opinion.

By the Court:

J. WILLIAM DITTER, JR., J.

Entered: 5/21/80

Clerk of Court

APPENDIX B

Judgment Order of the United States Court of Appeals for the Third Circuit

UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Nos. 80-1298/99 and 80-1992/93

In the Matter of READING COMPANY,

Debtor

STATE OF NEW JERSEY,

Appellant

Appeal from the United States District Court
for the Eastern District of Pennsylvania

C. A. No. B-71-0828

Argued September 19, 1980

Before: ADAMS, HUNTER and HIGGINBOTHAM, Circuit Judges

JUDGMENT ORDER

After consideration of all contentions raised by appellant, it is

ADJUDGED AND ORDERED that the judgment of the district court be and is hereby affirmed.

Appendix B

Each side to bear its own costs.

By the Court,
ARLIN M. ADAMS
Circuit Judge

Attest:

SALLY MRVOS
Sally Mrvos, Clerk

Dated: Sep 23 1980

APPENDIX C

Order of the United States Court of Appeals Denying Petition for Rehearing

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 80-1993

In the Matter of READING COMPANY,

Debtor

STATE OF NEW JERSEY,

Appellant

SUR PETITION FOR REHEARING
EN BANC

Present: SEITZ, *Chief Judge*, ALDISERT, ADAMS, GIBBONS, ROSENN, HUNTER, WEIS, GARTH, HIGGINBOTHAM and SLOVITER, *Circuit Judges*.

The petition for rehearing filed by Appellant, State of New Jersey, in the above entitled case having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular

active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

By the Court,
ARLIN M. ADAMS
Circuit Judge

Dated: October 17, 1980